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Defaults and Repudiations of Foreign Loans

This report, prepared for the INFORMATION SERVICE by Dr. Max Winkler, contains a brief review of foreign loans in default. The importance of accurate information relating to defaults and repudiations is emphasized by the rapid extension of American investments abroad, which during the past few years have placed the United States in a new position as the world's greatest creditor nation. The past records of borrowing countries and the details of the banker's contracts, however, are not readily available. The most commonly used source of information is the banker's prospectus, which, published for the purpose of disposing of issues, is not always complete. The American investing public, as Dr. Winkler points out, should have access to detailed and correct information. While the following study is not exhaustive, it attempts to present an impartial, and so far as possible, an accurate summary of foreign loans and defaults.—Ed.

CONSIDERABLE space is being given in the press to the remarkable growth of the United States as a creditor nation. We are constantly reminded that our foreign invest-

ments, begun only relatively recently, have reached sums which it has taken continental European lending powers many generations to accumulate. America's investments abroad, exclusive of so-called political obligations, placed at about \$11,000,000,000, are estimated by the writer, as of December 31, 1927, at close to \$14,500,000,000, in comparison with Great Britain's maximum foreign investments prior to the war of about \$20,000,000,000. Within the brief span of thirteen years we have managed to send abroad nearly three-fourths of the total which England has succeeded in investing abroad during ten times as long a period.

Quo usque tandem? How much further can we go with safety? Although we have covered practically the entire world, our funds having been placed in every country of the universe, we may state with a reasonable degree of certainty that the field is by no means exhausted. We are bound to witness in years to come further marked expansion in our foreign investments with corporate issues, both stocks and bonds, likely to play a much more prominent part than heretofore. Are we going to remain im-

mune from the losses which have been experienced by other creditor nations, losses incident upon possible defaults and repudiations? Is it not probable that some day certain of the foreign issues, offered today as fundamentally secure investments, might default, as happened, for instance, to Russian bonds which only ten years ago were recommended by American bankers to our investing public as "investments?" Of course, as long as events are running along smoothly, that is, as long as nothing happens to interfere with the payment of interest, and occasionally the payment of sinking funds on loans extended to foreign borrowers, few will be inclined to heed whatever warning may be issued by those who base their judgment of the future by what has happened in the past.

INVESTING PUBLIC LACKS FULL INFORMATION

Unfortunately, there are few indeed who volunteer information to the American investing public as to the past record of present or prospective borrowers. What our investor learns about past fiscal records is hardly anything outside the data presented in the prospectus, and prospectuses are generally prepared for the purpose of disposing of issues rather than with a view to educating the investor. When one reads, for example, that a certain South American nation has never defaulted, although it has defaulted at least twice, once with respect to interest and once with respect to sinking fund payments, or that a Latin American municipality has "for the past twenty years" promptly met its obligations, although it has not borrowed in twenty years, but had borrowed twice before, defaulting on each occasion, it is difficult to understand why our underwriters cannot manage to obtain and lay only accurate information which is not misleading before the investor.

If in the course of time a default should occur in any of the issues referred to above, or such other issues as would come within the same category, the holder of such issues will doubtless contend that had it not been for the statements made in the prospectuses, he would not have acquired the loans in question. The famous (*sic*) hedge clause

(information secured by cable and subject to correction), or similarly meaningless phraseology, might not in the end afford quite the protection which is expected from them. Occasionally, statements contained in prospectuses are not without a good deal of humor. A circular descriptive of a German Catholic issue reads that, of the total population of the country, thirty-three per cent profess the Roman Catholic faith, while the prospectus describing a German Protestant loan tells us that 67 per cent of the German population are Protestants. Why these two circulars should conspire to extinguish all other religions in Germany—a nation with which we are at peace—it is very difficult to comprehend.

During 1922, an American banking firm underwrote and offered to the American investing public a \$2,000,000 issue on behalf of a Brazilian state, which, at the time of the flotation of the loan, was in complete default on its entire debt. Our investors were told nothing about the status of the indebtedness of the state in question, and apparently the State Department offered no objection to the new loan.

About two years later, a Texas firm offered, or attempted to offer, a \$50,000,000 loan on behalf of Mexico, the offer synchronizing with the collapse of the debt agreement reached between the Mexican Government and the international bankers. No voice of warning was raised by any one of our bankers and statesmen charged with the guidance of our investment policies. However, when the city of Vienna attempted to raise a loan in this market last spring, a vigorous protest was ordered because Vienna refused to pay 100 cents on the dollar to those who had purchased Vienna pre-war loans at absurdly low figures.

REPAYMENT OF PRINCIPAL A MINOR CONSIDERATION

Repayment of principal very often constitutes as serious a problem in the minds of investors in foreign government, state and municipal securities as the continuance of payment of interest. Careful analysis, however, of past fiscal records of governments reveals that inability to pay off in cash maturing obligations has rarely, if ever,

been the cause of serious concern to the lenders. Repayment of loans, especially those issued in behalf of governments, appears to be a custom of relatively recent origin.

The institution of lending goes back, perhaps, into the earliest period of mankind and examination of ancient loan contracts generally seems to contain no reference to a fixed date of maturity. More than 2,000 years ago, the Greek City of Miletus secured a loan from a neighboring city. The citizens of Miletus, both male and female, were called upon to subscribe for bonds in amounts of 3,000 drachma, or multiples thereof, by submitting their names to the Clerk of the City Council. Names were entered upon a subscription list, which was left open for a certain period of time. Of the amount subscribed, two-thirds was payable immediately upon subscription, the remainder being payable at the close of the year. Miletus agreed to pay interest at the rate of ten per cent per annum, payable monthly. Express guarantees were given against any change in the interest rate agreed upon. No provisions appear to have been made for the repayment of the loan which constitutes in all probability the first perpetual loan ever offered by a municipality.

THE ISSUANCE OF PERPETUAL BONDS

Modern governments have often taken recourse to the issuance of perpetual bonds, and in France today investors purchase *rentes*, i. e., income rather than a certain par value amount of bonds. It has been stated that a majority of British holders of a certain Russian bond petitioned the Russian Government, at the expiration of the life of the loan, to convert the latter into a perpetual bond instead of redeeming it in cash. The Russians are said to have given their consent to the petitioners. The magnitude of American investments abroad need not, therefore, cause serious apprehension in the minds of American investors in foreign securities over the difficulty which the respective borrowers might have in repaying all the enormous sums that have been loaned. The actual redemption in cash of a loan is not of prime importance. Prompt payment

of interest and the likelihood of refunding old debts are far more important considerations. Fixed dates of maturity often entail serious hardship to the borrower. Repayment may synchronize with periods of great money stringency, or with financial and economic crises, thereby rendering it difficult, if not impossible, to readily repay maturing obligations. However, failure on the part of the borrower to pay interest, or failure to meet agreed upon sinking fund payments or maturing obligations on a stipulated date, constitutes a distinct violation of agreements and is regarded in financial language as a default or bankruptcy. According to von Heckel,¹ "Government bankruptcy is the violation on the part of the state in question of the rights of its creditors in failing to fulfill its obligations in whole or in part, with or without the state's express announcement to that effect."

EARLY HISTORY OF DEFAULTS

Defaults are by no means of recent origin. Their history goes back to the earliest period of mankind, their origin being contemporaneous with the institution of lending. The Psalmist defines the righteous man, *inter alia*, as one "who sweareth unto his neighbor and disappointeth him not." In Greece, in the days of Solon, the frequency of defaults provoked the government to introduce a clause against violation of lawful claims in the oath taken by every citizen, and in Rome the demand for *Novae Tabulae*, readjustments, was distressingly frequent. It is of interest to point out that the *Leges XII Tabularum* provide among other things that the body of a defaulter may be divided and distributed *pro rata* among the creditors. Real estate mortgages, issued in Germany prior to and during the Thirty Years' War in the seventeenth century, were valorized after the conflict on the basis of their pre-war value, thereby offsetting the losses to the investor resulting from the depreciation of the currency. It is of especial interest to note that practically all credits advanced during this period—admittedly one of uncertainty—contained a clause to the effect that payments are to be made at the option of the creditor, either

1. Manes, A., *Staatsbankrotte*, p. 16.

in the country's legal currency, or in the currency of any other country in which there appeared to be a greater degree of confidence.

To be sure one should not attach too much significance to early financial records of governments, particularly if the latter have for a relatively long period been meeting their obligations faithfully. We should not, for instance, ostracize a Greek loan because Greece in the days of Solon was guilty of default, nor should we condemn an Italian loan because Rome defaulted after the Punic wars. Nevertheless, past records are worth studying, particularly the circumstances under which defaults occurred, prior to endorsing new obligations of such borrowers.

PERCENTAGE OF DEFAULTS SHOWS MARKED DECREASE

That the attitude of governments toward their creditors has within recent years undergone a marked change for the better is evidenced by the tables reproduced elsewhere in this study. Whereas fifty years ago more than one-half of all the foreign government loans listed in London were either wholly or partly in default, the percentage at the present time is only twenty-four. Our own experience has been more favorable. Of all foreign government loans listed on the New York Stock Exchange only one issue, the Hukuang Railway 5s, is at present in complete default.

Eliminating Russia, whose default is rather unique in that it differs materially from that of other nations, the picture revealed by the accompanying table is not discouraging. We find that the aggregate indebtedness of governments, states and municipalities, as well as obligations guaranteed by governments and other political subdivisions, approximates \$5,900,000,000. The amount outstanding totals about \$2,784,000,000, indicating that \$3,116,000,000, or slightly less than 53%, has been repaid. The amount of interest in arrears is \$865,000,000, or about 14.66% of the amount originally issued. This percentage does not, however, reveal a thoroughly clear picture. The situation is more readily appreciated if we take into account the following: The total debt of governments and political subdivisions, together with such obligations as are guaranteed by them, aggregates \$145,000,-

000,000. The outstanding amount in default inclusive of Russia is about \$19,784,000,000, or 13.64% of the total. If we exclude Russia, the amount in default represents less than 1.85% of the total. It is safe to state that no other group of securities can point to such a record, notwithstanding the defaults and repudiations of which nations have from time to time been guilty.

While American bankers have been competing keenly for, and American investors have been eagerly subscribing to, Norwegian loans, it is learned that, since the decision last August by the Supreme Court of Norway that a commune or municipality may be declared bankrupt, no less than six (according to reliable information received from Norway the number is seven)^{1a} communes have declared their inability to meet their financial obligations, and have been placed under the supervision of the Central Administration. Commenting on this development, the United States Department of Commerce states that "such a bankruptcy does not mean that a liquidation will take place as in the case of an individual, but rather that the commune or municipality declares its inability to meet the present demand for payment of obligations incurred and that a new arrangement must be made."

To guard against the occurrence of governmental default is well nigh impossible. Conditions obtaining in the country at the time of borrowing may be thoroughly sound, yet there is no assurance that the situation might not in the course of time so change as to make default practically inevitable. Occasionally, however, the position of the borrowing nation at the time of borrowing is such as to render the outlook for continued payments on loans not especially promising.

PRINCIPAL FORMS OF DEFAULTS

Government defaults may assume one of the following forms:

1. Reduction in the rate of interest
2. Delay in payment of interest
3. Suspension of payment of interest
4. Reduction in the rate of interest through the levy (subsequent to the flotation of the loan) of taxes upon the rate of interest agreed upon

^{1a}. See remarks under Note 12, p. 247.

5. Delay in payment of principal
6. Forced conversion of loans
7. Reduction in principal amount of loan
8. Payment of "gold" loan in depreciated currency
9. Reduction in the amount of sinking fund payments
10. Suspension of sinking fund
11. Reduction of both interest and sinking fund
12. Repudiation of both interest and principal

DIVIDED RESPONSIBILITY FOR DEFAULTS

Responsibility for default is believed by some to lie almost entirely with the borrower. We may, however, inquire as to whether certain defaults would have occurred if ordinary common sense financial canons had been observed during the issue of the original loans. The lender is at least as much morally responsible as the borrower, if not more so, to insure that a given loan does not carry in itself the seeds of eventual default. Repudiation of obligations would indeed be a rare occurrence if the borrowers were always accorded fair treatment. Many thoughtful students of government finance are not inclined to lay all the blame upon Colombia for "defaulting" on a loan which, to begin with, was to a large extent the result of an adjustment of claims, many of which were of a doubtful character—a loan of \$10,000,000 on which interest was to be paid at the rate of ten per cent per annum, and from which interest and commissions were deducted for two years in advance, leaving only about \$3,200,000 for Colombia. In addition, the expenditure of this sum was entrusted to contractors who secured for the country "a toy navy and military stores."² Even if these purchases represented full value, which they did not, Colombia was to pay well over 31 per cent for the privilege of being financed by European bankers.

An illustration of how defaults may be invited by bankers is afforded by the terms under which Greek loans were arranged during the first quarter of the nineteenth century. At a banquet in the Guildhall, presided over by the Lord Mayor of London, on February 21, 1824, a Greek loan of about \$4,000,000, bearing interest at five per cent per annum, was underwritten at 59 per cent. In 1825, a \$10,000,000 loan was underwrit-

ten at 56½ per cent. It appears that only \$1,375,000 was sent to Greece. Liberty-loving bankers and politicians were thus well rewarded for their enthusiasm over the struggle of Greece for independence. To be sure, it was half a century before the Greek Government on its part evinced its gratitude by paying interest upon these loans.³

THE RECORD OF HONDURAS

Had it not been for the unfair advantage which bankers have often taken of conditions in Latin American countries, it is safe to assert that the fiscal record of some of these countries would not read like a "Handbook of Financial Pathology," i. e., defaults would not have occurred with such distressing frequency. An itemized account of the record of Honduras covering the past 100 years will illustrate this view.

Year

- 1827 Creation of Honduras debt of £27,200 (\$136,000) 6% bonds consequent upon the breaking up of the Central American Federation. No interest was paid on this debt of Honduras.
- 1867 Conversion Loan 5s of £90,000 (\$450,000) issued to convert 1827 loan and interest in arrears and for liquidation of other liabilities. Old bondholders received £55,000 new bonds.
- 1867 Issuance of Railway loan of £1,000,000 (\$5,000,000) at 80%, bonds bearing interest at 10% per annum. Government agreed to provide an annuity of £140,000 for 15 years, and to give subscribers half of the profits of the proposed Railway for 15 years after redemption of loan.
- 1869 Issuance of Railway loan of £2,490,108 (\$12,450,540) at 75%, bonds bearing interest at the rate of 6 2/3% per annum.
- 1870 Issuance of Railway loan of £2,500,000 (\$12,500,000) at 80%, bonds bearing interest at the rate of 10% per annum, with sinking fund of 3% per annum.
- 1872 All loans default, interest having been paid out of proceeds from the sale of bonds.
- 1875 Parliamentary Commission investigates Honduran loans.
- 1887 Concession granted for completion of Railway. Existing bonds to be exchanged with interest in arrears for £100 shares of a new Railway Company.
- 1888 Formation of new Railway Company.
- 1892 Honduras Government declines to renew concession at expiration.
- 1893 Cancellation of concession granted to an

². Jenks, L. H., *The Migration of British Capital to 1875*, p. 46-47.

³. *Ibid.*, p. 50-51.

- American Company, which contained no provision for debt settlement.
- 1896 New concession granted, providing for settlement of external debt. Terms of settlement inequitable. Concession lapses.
 - 1897 Contract between Honduras and American Syndicate for building of railway, settlement of external debt and establishment of bank charged with collection of customs. Syndicate fails to carry out contract.
 - 1900 Concession revoked. Congress approves new contract.
 - 1902 Syndicate again fails to carry out contract. Honduras grants extension in time of one year.
 - 1903 Syndicate once more fails to execute works required under contract. Government takes possession of Railway.
 - 1904 Settlement of debt proposed. Rejected by bondholders.
 - 1909 Arrangement for settlement of external debt proposed. Substitution by United States of new plan to settle debt.
 - 1910 American group declines to proceed on terms proposed.
 - 1911 Honduras rejects terms of settlement.
 - 1912 American group withdraws from Agreement of 1909.
 - 1923 Arrangement of debt approved by bondholders
 - 1926 Honduras Congress ratifies Agreement. Honduran loan contracted in American market.

The terms of this Agreement are sufficiently interesting to warrant their inclusion within the present study.

ARRANGEMENT OF THE FOREIGN DEBT OF HONDURAS⁴
(As ratified by the Congress of Honduras,
March 9th, 1926)

RAMON ALCERRO CASTRO, Secretary of State in the Department of Finance and Public Credit of the Republic of Honduras, and JUAN R. LOPEZ, Financial Agent of the Government of Honduras, both representing the Government of the Republic of Honduras, of the one part, hereinafter referred to as "the Government," and ARTHUR HENRY WILLIAM KING, as representing the Corporation of Foreign Bondholders of London, jointly with the Committee of Holders of Honduras Bonds, legally and duly authorized, as it appears in the substituted Power of Attorney annexed, granted in London on the eighteenth of September, One thousand nine hundred and twenty-three, and hereinafter referred to as "the Corporation" of the other part; have agreed to enter into and in effect they do enter into, the following arrangement for the total cancellation of the External Debt of Honduras, arising out of the four foreign Loans of 1867, 1869 and 1870, obtained in the London and Paris markets at different rates of issue and interest.

⁴. See Corporation of Foreign Bondholders, 53rd Annual Report, London, p. 246-9.

ARTICLE 1.

For the purposes of this Arrangement, the Bonds of the four above-mentioned Loans shall be treated alike and as of equal value.

ARTICLE 2.

The sum of £452,000 (four hundred and fifty-two thousand pounds sterling) is taken as the basis of the arrangement for the representative value of the External Debt arising out of the four Loans of 1867, 1869 and 1870, cumulative interest at 8.86 per cent, being admitted on this sum during the period of its amortization, which is fixed at thirty years in half-yearly payments of £20,000 each, or £1,200,000. Consequently, the Corporation abandons all claims on account of arrears of interest accumulated on the Bonds, and likewise abandons the right to interest on the said Bonds in the future and binds itself to accept in payment of the said Debt the net sum of £1,200,000 sterling, which shall be paid half-yearly during thirty years, at the rate of £20,000 each half-year. It is agreed and accepted by both parties that on the termination of the liquidation of the Debt in the form specified in this Contract, the Republic of Honduras shall be solvent in relation to the Corporation, and that *ipso facto* the ~~lines~~ established by the Government in order to guarantee the four Loans herein referred to shall be cancelled.

ARTICLE 3.

In fulfilment of the present Arrangement, the Government shall pay to the Corporation, in the manner hereinafter specified, the sum of £20,000 half-yearly; and the Corporation, on receipt of said sum, shall deliver, duly cancelled, to the Government, through the intermediary of the National City Bank of New York, or other Bank of recognized credit, accepted by the parties, an amount of Bonds proportionate to the instalment received. The said Bonds shall be delivered to the Bank in this proportionate manner until their complete and total redemption in accordance with the following conditions: (a) During the first fifteen years of the existence of the present arrangement, the Bonds will be amortized at the rate of 20 per cent; and (b) during the last fifteen years, the Bonds will be amortized at the rate of 25 per cent.

ARTICLE 4.

The half-yearly payments of £20,000 shall cease on the part of the Government as soon as there have been cancelled and delivered to the Government the Bonds deposited in the Offices of the Corporation in accordance with this Arrangement and thereupon the Debt of the Government arising out of the four Loans of 1867, 1869 and 1870 shall be cancelled. But it is understood and agreed that the total of the payments shall never exceed the sum of £1,200,000 sterling.

ARTICLE 5.

If it should happen that the proceeds of the Consular Revenues of which mention is made in the present Arrangement do not suffice, in any given half-year, to complete the payment of the respective instalment of £20,000, plus the sum of £500

mentioned in Article 9, the deficit shall be paid from the proceeds of the first revenues of the following half-years, without incurring interest.

ARTICLE 6.

A period of two years, reckoned from the date on which this Arrangement enters into force, is granted, in order that the holders of Bonds of the four Loans, who have not already done so, may deposit their Bonds in the Offices of the Corporation. Within the six months following the period of two years referred to, the Corporation undertakes to present to the Government a statement certifying as to the total of Bonds deposited, these being the only Bonds for which the Government shall be under the obligation to pay, whatever may be the nationality of the owners thereof.

ARTICLE 7.

The Corporation is charged with the carrying into effect of all the details which concern it in connection with this Arrangement. It is understood that the method of application of the half-yearly payments, either by the purchase of the Bonds or drawings for redemption, remains at the sole discretion of the Corporation, and that it can act as it may deem best in the interest of the Bondholders, always provided that delivery of the stipulated amount of cancelled Bonds is made each half-year in accordance with Article 3. The Corporation may fix and vary from time to time the rate of drawings as the sums in its possession permit, and the Government shall not have the right to call for the delivery of more Bonds than the quantity stipulated in respect of each half-year, this notwithstanding that purchases or drawings of Bonds in excess of the said quantity may have been effected in anticipation of subsequent deliveries. In case any of the Bonds deposited suffer, in the opinion of the Corporation, from any defect, the Corporation shall require from the respective holder a guarantee in order that the Government may not suffer any damage in consequence thereof, the Government being notified thereof with the corresponding remarks.

ARTICLE 8.

As guarantee for the payment of the half-yearly instalments of £20,000 each, and the expenses of the Debt service referred to in Article 9, the Government shall apply the proceeds of the 3 per cent Consular Service on all Consular Invoices for merchandise consigned to Honduras, created by Legislative Decree No. 6 of the 21st May, 1923. This Service of 3 per cent shall be collected compulsorily and exclusively by means of special stamps, which shall be deposited in the hands of the National City Bank of New York or other Bank of recognized credit accepted by the parties, for sale to the exporters for the payment of said Service, as may be necessary. The Government undertakes that during the execution of this Arrangement the said Bank shall always be provided with stamps. It is therefore agreed that as guarantee for the present Arrangement this Service shall have priority over

any other similar Service that may be established in the future. It is also understood that the other Consular Revenues are included in the guarantee for the execution of the present Arrangement. The Bank shall remit to the Corporation, for account of the Government, the funds collected by it up to the sum of £20,000 each half-year, together with the expenses of the service of the Debt mentioned in Article 9 so that the said sums may be in the hands of the Corporation, in London, at the end of each half-year, with the customary days of grace, commencing with the half-year ending 31st January, 1927. The Bank, as Collector of the Consular Service referred to in this Arrangement, shall set aside monthly from the said collections the sum of £3,417 corresponding to the proportionate instalment of the half-yearly payment of £20,500 indicated in Articles 8 and 9. The balance remaining will be placed by it at the order of the Government. The said collecting Bank shall notify the Government and the Corporation monthly of the amount of the revenues obtained.

ARTICLE 9.

To the half-yearly instalment of £20,000 there shall be added the sum of £500, which the Corporation shall apply to cover its expenses in the execution of the present Arrangement.

ARTICLE 10.

In the event of the Government failing absolutely to fulfil the present Contract, and voluntarily refusing to take proper measures to comply therewith, the Corporation shall have the right to terminate this Contract, and the holders of Bonds shall recover the rights they held prior to the signature of this Contract, but only in respect of uncanceled Bonds deposited with the Corporation.

ARTICLE 11.

It is agreed and accepted by both parties that, in the event of the Government failing absolutely to comply with this Contract, by reason of *force majeure* or fortuitous circumstances, on the termination of such an event the Contract shall continue to be complied with, in the terms already contained therein, until the complete cancellation of the Debt, but without incurring interest of payments discontinued during the period of suspension. *Force majeure* or fortuitous circumstances shall be considered and declared as such by mutual agreement of the contracting parties.

ARTICLE 12.

Any differences which may arise regarding the application of the provisions of this Contract shall be decided by arbitrators, one to be named by each party, or, in the case of disagreement, by an umpire appointed by mutual agreement.

ARTICLE 13.

The Corporation shall itself be responsible for the satisfaction of the claims of holders of Bonds deposited with it, arising out of the four Loans of Honduras, in accordance with the terms of this Contract.

ARTICLE 14.

This Arrangement will come into force on the 1st August, 1926, after it has received the approval of the National Congress.

In witness whereof they sign the present Arrangement, in triplicate, in Washington D. C., on the 29th day of the month of October, 1925.

R. ALCERRO CASTRO,
JUAN R. LOPEZ,
ARTHUR H. W. KING.

The prevailing characteristics of default indicate significant changes during recent years. The experience of the London market during the last half century illustrates this observation. Fifty years ago, about 54

per cent of the entire amount of foreign government obligations listed in London were in default, or about \$1,660,000,000 out of a total of \$3,070,000,000. At the beginning of last year (January 1, 1927), the percentage was only 24 per cent, or \$1,742,804,000, out of a total of \$7,211,108,900, of which the amount of Russian bonds listed in London in default accounted for nearly 20 per cent. The regional distribution of foreign government, state and municipal loans listed on the London Stock Exchange and the amount in default is presented in the accompanying table.

FOREIGN BONDS
(London Stock Exchange)

	Amount Listed	Amount in Default	Per cent of total
I. Governments and States			
Europe	\$4,452,541,500	\$1,521,857,500	34
South America	1,202,877,800	180,871,500	15
Central America*	239,335,800	11,212,500	5
Far East	832,533,900	28,862,500	3
Miscellaneous	483,819,900	.....	..
Total	\$7,211,108,900	\$1,742,804,000	24
II. Municipalities			
Europe	\$ 205,077,000	\$ 77,029,000	38
South America	101,143,500	15,426,700	15
Central America*	14,927,500	.....	..
Far East	45,075,000	.....	..
Miscellaneous	37,209,500	.....	..
Total	\$ 403,432,500	\$ 92,455,700	23
Grand Total	\$7,614,541,400	\$1,835,259,700	24

*Including Mexico, Cuba, and the West Indies.

A detailed statement regarding foreign loans in default is presented below. Particular attention has been paid to external

loans. The figures are the latest obtainable and may be assumed to be approximately correct as of July 1, 1928.

FOREIGN LOANS IN DEFAULT⁵

	Original Amount	Amount Outstanding (estimated)	Interest in Default (estimated)
Argentina			
Province of Corrientes 6s 1910 (1) ...	\$ 1,984,125	\$ 1,487,600	\$ 803,000
Province of San Juan 5s 1909 (2) ...	3,167,000	2,904,750	1,110,000
Total	\$ 5,151,125	\$ 4,392,350	\$ 1,913,000
Brazil			
State of Alagoas 5s 1906 (3)	1,500,000	1,500,000	975,000
State of Amazonas 5s 1906 (4)	16,800,000	16,047,300	10,450,000
State of Amazonas 5s 1915	4,100,000	4,100,000	1,650,000
State of Espirito Santo 5s 1908 (5) .	6,000,000	2,719,400	1,663,000
State of Para 5s 1901-02	7,250,000	6,372,300	1,593,000

5. For explanations of loans having numbers from (1) to (15) see Notes 1 to 15 in the text following.

	Original Amount	Amount Outstanding (estimated)	Interest in Default (estimated)
State of Para 5s 1907	3,250,000	2,860,500	1,072,000
State of Para Funding 5s 1915	5,106,600	5,106,600	1,915,000
State of Sergipe Funded debt (6) ..	1,000,000	905,400	166,500
City of Bahia 5s 1912-13	8,000,000	7,981,500	2,993,000
City of Bahia 6s 1914	7,605,000	7,605,000	5,475,500
City of Bahia 5s 1916	4,200,000	4,200,000	1,995,000
City of Para 5s 1905	5,000,000	4,605,200	1,261,500
City of Para 5s 1906	3,000,000	2,852,000	998,200
City of Para 5s 1912	3,000,000	2,954,300	1,034,000
City of Para Funding 5s 1915	3,711,600	3,711,600	1,299,000
City of Para Treasury 6s 1919	1,363,300	1,363,300	408,500
City of Manaus 5½s 1906 (7)	1,750,000	1,349,000	816,500
Port of Para 1st 5½s 1906-10 (8) ..	18,000,000	17,520,000	5,781,500
Port of Para 2nd 5 1911-13	21,643,500	21,439,000	6,431,500
Total	\$122,280,000	\$115,192,400	\$ 47,978,700
Bulgaria			
City of Sofia 5s 1906 (9)	7,000,000	5,909,000	2,954,500
China			
Secured and unsecured debt .....	.....	338,041,500	156,000,000
Ecuador			
Guayaquil & Quito 5s 1897	12,282,000	10,732,000	8,200,000
Condores Guaranteed 4s	417,000	356,500	213,500
French Railway 5s 1909-11	1,800,000	1,800,000	1,350,000
Port de Bahia Caraquez 6s 1913	700,000	700,000	630,000
Total	\$ 15,199,000	\$ 13,588,500	\$ 10,393,500
Jugoslavia			
Montenegro 5s 1909 (10)	1,250,000	1,105,800	332,000
Latvia			
Riga 4½s 1914 (11)	\$ 6,409,200	\$ 6,409,200	\$ 3,172,500
Mexico			
Nat'l Rys. of Mexico 4s 1907	160,000,000	50,748,575	28,344,313
Nat'l Rys. of Mexico Prior Lien 4½s 1907	225,000,000	84,804,115	45,794,221
Nat'l Rys. of Mexico 6s 1913-14 .....	.....	5,529,132 }	23,226,863
Nat'l Rys. of Mexico 6s 1913-14 .....	.....	28,133,000 }	
Vera Cruz & Pacific RR Co. 4½s 1904.	7,000,000	7,000,000	3,780,000
Nat'l RR Co. of Mexico 4½s 1902 ...	23,000,000	23,000,000	13,320,215
Nat'l RR Co. of Mexico 4s 1902	27,289,000	24,740,000	11,875,200
Mexican Internat'l RR Co. 4½s 1897 .	6,000,000	6,000,000	2,709,000
Mexican Internat'l RR Co. 4s 1897 ...	16,000,000	4,206,500	1,940,000
Pan American RR Co. 5s 1903	2,400,000	2,003,000	1,201,800
Pan American RR Co. 5s 1903 ... ..	.....	1,484,000	890,400
Mexican Central Ry. Co. Ltd. 5s 1901 .	.....	1,374,000	824,400
Mexican Central Ry Co. Ltd. 5% Equip- ment notes .....	.....	1,063,345	637,600
Tehuantepec Nat'l Ry. 5s 1902,4,5	10,000,000	9,776,500	3,910,600
Tehuantepec Nat'l Ry. 4½s 1905	2,000,000	1,927,700	694,000
State of Aguascalientes Int. 5s 1910 ..	650,000	650,000	331,500
State of Chihuahua Silver 5s 1900 ...	.....	299,040	194,400

	Original Amount	Amount Outstanding (estimated)	Interest in Default (estimated)
State of Coahuila 6s 1900	752,000	752,000	579,000
City of Cordoba Silver 6s .....	.....	413,300	322,400
State of Durango 5s of 1907 and 1910.	1,700,000	1,700,000	830,000
State of Jalisco Gold 6s of 1898 and 1900	2,500,000	2,500,000	2,066,900
State of Jalisco Silver 6s .....	.....	418,600	
State of Morelos Silver 6s .....	.....	90,700	70,700
City of Oaxaca 5s 1910	900,000	900,000	594,000
City of Parral Silver 6s .....	.....	149,520	.....
City of Saltillo Gold 6s .....	.....	234,300	182,700
City of Saragosa Silver 5s .....	.....	1,744,400	1,343,200
State of San Luis Potosi 6s 1889	1,000,000	936,500	720,800
Total .....	.....	\$262,578,227	\$146,384,412
Norwegian Municipalities (12)			
Portugal			
City of Lisbon 4s 1886 (13)	11,800,000	6,700,000	2,948,000
Russia (14)			
.....	.....	17,000,000,000	8,500,000,000
Turkey (15)			
.....	.....	1,942,500,000	185,500,000
United States of America			
Alabama .....	.....	13,000,000	43,550,000
Arkansas .....	.....	8,700,000	29,146,000
Florida .....	.....	8,000,000	26,800,000
Georgia .....	.....	13,500,000	45,125,000
Louisiana .....	.....	6,000,000	20,100,000
Mississippi .....	.....	7,000,000	24,450,000
North Carolina .....	.....	13,000,000	43,550,000
South Carolina .....	.....	6,000,000	20,100,000
Former Confederate States 7% Cotton loans .....	.....	12,094,000	54,181,120
Total .....	.....	\$ 87,294,000	\$307,001,120
Grand Total*	\$22,900,000,000	\$19,783,710,977	\$9,364,577,732

*Partly estimated.

NOTE 1. The loan issued in behalf of the Province of Corrientes defaulted with respect to interest August 1, 1916. Interest due on that date was paid on June 2, 1919; the coupon due February 1, 1917 was paid July 1, 1919; and the coupon due August 1, 1917 was paid February 16, 1920. Coupon due August 1, 1918 was paid February 1, 1921; and that due February 1, 1919 was also paid in the course of 1921. Subsequent coupons are in arrears and sinking fund payments providing for annual drawings of bonds to the amount of five per cent of the issue beginning with 1911 have not been taken care of at all.

According to recent information, the Province has authorized the flotation of an internal loan for the purpose of adjusting its external indebtedness.

NOTE 2. With regard to the Province of San Juan External Loan, the following comments published in an article in *La Prensa*, under date of September 29, 1927, should prove of particular interest to American bankers and investors, especially in view of the likelihood that a loan on behalf of the province is scheduled to be sold in this market:

A recent decree handed down by the Supreme Court of Justice of Buenos Aires has declared that the external credit of a state constitutes an obligation not only towards the nation to which the debt is owed, but towards all nations with which the debtor state entertains friendly relations. In consequence, the repudiation of the external debt and the methods which are employed in not paying at all, or in paying less than originally agreed upon, tends to seriously impair the honor of the nation involved.

The origin of this categorical declaration is intended to be considered as a last warning to governments which have caused a nation to contract obligations, and which subsequently are desirous of avoiding the consequences of engagements, thereby profiting by the favorable circumstances of the debtor, but inflicting damage upon the creditors, similar to the other decisions which were based upon the depreciation of the currency.

The Province of San Juan issued a decree providing for the repayment of its external debt by remitting to the bondholders the sum of \$2,896.72, although interest and amortization alone amounted to \$219,305.95 a year. Payment having been refused by the bondholders, the Province deposited the above amount and began a lawsuit asking that the repayment of the loan in the above manner be declared valid and that the defendants be obliged to cancel the debt to them by the Province and to pay damages and expenses incurred in connection with the lawsuit.

The bondholders called attention to the fact that the Province wished to liquidate a loan of \$2,500,000 either with an amount or a currency which at the time of payment represented little, if any, value. Another series of considerations, such as the invalidation of the decree because the bondholders lacked the faculty of filing an answer, the desire to liquidate the debt with a currency which was not indicated in the text of the security in question, etc., compelled the defendants to ask that the action, which had been started, be dismissed.

The Supreme Court, after careful deliberation, handed down a decision to the effect that the Province of San Juan has, when commencing the lawsuit, failed to take into consideration the elementary duties towards the financial honor of the whole Republic. The sentence expressly states that the external credit of a state is a matter concerning the whole nation, that the good faith of its administrators is obliged to protect it, and that whatever means there are at their disposal for the execution of only a part of the engagements which have been entered into under the Provincial guarantee tend to adversely affect the Nation's honor.

The explicitness of these words renders all comments unnecessary. No matter what sacrifice is demanded of a public treasury to keep its word, it must be done by the administration. To take advantage of casual circumstances, such as the drop in currency, to evade obligations, to think only of the immediate material advantages of an absurd

payment, that is forgetting that the honor and reputation of a well organized country in the eyes of the world at large stands above a few thousand pesos.

These considerations must not be limited exclusively to the external debts. It is logical that they apply also to those contracted in the home market, as there cannot be two ways of judging the honor of a state, one to be applied beyond the frontiers, and the other to be applied to the interior of the country. London, Berlin and New York banks are just as well creditors as the banks at Rosario and Buenos Aires, and, if it be true that the effect of a delay in the payments of some coupons would not have as much repercussion on some as on others, the principle to be applied must be the same.

The decision is very opportune at this time, when so many loans are being contracted and when one should remind the provincial governors that their chief aim must be to keep the country out of debt, which may be beyond the capacity of the Province in question. The evasion of engagements is equivalent to an offense against the honor of the State and the good faith of a Nation, which, when it contracts loans, does so with the full understanding that it will endeavor to honor the same.

NOTE 3. Interest payments on the State of Alagoas 5% Loan of 1906 appear to have been made very irregularly. While the service on the English portion of the Loan is being met promptly, the service of interest and sinking fund on the bonds of the French series of this Loan, amounting to Fcs. 7,500,000, was suspended on January 1, 1916, and appears to be still in default. On March 13, 1922, the *Association Nationale des Porteurs Francais de Valeurs Mobilières* of Paris brought suit against the State in the Paris Courts, for the purpose of determining the exact obligation of the State in respect to the French issue of the Loan, and of enforcing the same, if possible.

NOTE 4. All external loans of the State of Amazonas are in complete default. However, according to recent information, the President of Amazonas signed a contract with the Brazilian Federal Treasury, under date of November 4, 1927, in accordance with which the Brazilian Federal Government is to endorse a loan of 40,000,000 milreis to be obtained for the State by the Banco do Brazil. The Loan is to be used to pay off the State's external and internal obligations.

NOTE 5. In connection with the State of

Espirito Santo 5% Loan of 1908, it is worth noting that, under date of June 9, 1927, the *Association Nationale des Porteurs Francais de Valeurs Mobilières* announced that more than 55% of the holders of the bonds had agreed to the offer made by the State to repurchase the issue. Owners of bonds are to receive, beginning with June 1, 1927, the sum of Fcs. 325, plus interest on this amount from April 5 to May 31, *viz.*, Fcs. 2.55, or a total of Fcs. 327.55, against delivery of coupons 13 to 38, due from October 5, 1914 to April 5, 1927. The obligation was to be subsequently delivered, before January 31, 1928, at the rate of Fcs. 500, plus interest from April 5 to date of delivery. The notice advised the holders that they were to take advantage of this offer prior to September 1, 1927. The time was subsequently extended to October 31. The settlement above mentioned was made after deduction of certain French taxes, in accordance with the terms of Article 1 of the Agreement. Date of delivery of the obligation was later fixed at January 20, 1928, at the rate of French Fcs. 291.125 net, for Fcs. 327.55 gross.

NOTE 6. No details are available in regard to the State of Sergipe Loan. The amount mentioned above is based upon a statement which appeared in the United States Bureau of Foreign & Domestic Commerce *Latin American Financial Notes*, under date of December 5, 1927. The writer suspects that the debt of the State represents a loan arranged privately by American bankers to the State in 1923.

NOTE 7. With regard to the City of Manaus, it is of interest to note that, although revenues have shown a steady increase, the City's financial condition has not improved. According to a statement made by the Mayor to the City Council in April, 1927, "it was very difficult to see how the City could meet the charges on its foreign and internal debts without imposing higher taxes and creating new ones." Business leaders maintain that business suffers from the fact that the City is already over-taxed, and they maintain that there should be no additional tax burden. It does not seem possible for the City to pay off its foreign debt without some assistance from the Federal Government.

The State of Amazonas is, as mentioned above, about to obtain accommodations from the Federal Government and it is believed that this City might also secure aid from that source.

From the outset it has been the announced purpose of the Mayor now in office to normalize the city's financial situation. The Ethelburga Syndicate (Ltd.) of London, the depository for the bankers and for holders of the bonds of 1906, expressed its willingness to accept suggestions for a settlement. The Mayor pointed out that the sum of £24,750 required for the annual service was at the present rate of exchange equivalent to over 1,014 contos; that such a sum would absorb more than half of the city's revenue; that it would be impracticable to resume the payment of such charges in accordance with the contract now in force because it would disrupt the city administration and thereby sacrifice the population of the city; that the resumption of the service depended on the adoption of a new system of interest and amortization payments; that the only way to resume payment would be to modify the present contract by prolonging the period for redemption or to effect a new funding operation by virtue of which annual obligations would be reduced; and that, in any case, the city could not dispose of more than £4,000 sterling out of its present revenues to take care of the payments on its foreign debt.

The syndicate in its reply to the Mayor in January, 1927, made it plain that it was convinced that the present financial situation of the city would permit it to make larger payments. The syndicate called attention to the fact that in 1919 a funding agreement was concluded between the city and the syndicate, but apparently because of some friction between the then Mayor and the City Council, the contract was not signed. The Mayor has advised the syndicate that a funding operation, on the basis proposed, is now absolutely imperative.

The financial situation of the city has for a long time been uncertain, and it seems that this uncertainty is likely to continue for many years regardless of the general economic situation. The demand for funds for paving and repaving streets is now one of

the municipality's most serious responsibilities. Although the city has been committed to this work, it has been neglected in recent years. It might be noted, in passing, that the annual budgets are prepared in such a way as to show no deficit, for they do not include any items for interest or amortization charges on the external and internal debts.

NOTE 8. In connection with the default on the Port of Para Bonds, it has been stated that "owing to the non-payment of the guarantee by the Brazilian Government, meetings of bond holders were held September 13 and 27, 1922, and a moratorium was granted to the company by the bond holders." The concern was incorporated under the laws of the State of Maine and its obligations are largely held abroad.

NOTE 9. The City of Sofia Loan of 1906 was offered by a syndicate headed by the Berliner Handelsgesellschaft, to the amount of 35,000,000 leva (gold), or about \$7,000,000. The principal and interest on the loan are scheduled to be paid at the option of the holder in gold leva, German marks, French francs, Austrian-Hungarian crowns, or Dutch guilders, at the rate of twenty-five gold leva equal to Fcs. 25, or M. 20.25, or K. 23.80, or Fl. 12.

Bonds are guaranteed by the Bulgarian Government and, in addition, are secured by the City's revenues derived from various sources. The service is being met only in paper leva, which are worth less than 4% of the gold leva.

It is understood that the City is negotiating for an external loan and, in connection with negotiations for additional borrowing, it is believed that an arrangement will be made concerning the adjustment of this obligation.

NOTE 10. The service on the Montenegro Loan has been taken care of promptly since 1923. Interest appears to have been in arrears for the period 1916-1922. It is expected that the adjustment of this matter will be effected in the very near future, especially in view of the attempt on the part of Yugoslavia to obtain additional loans abroad.

NOTE 11. According to an article in the *Rigasche Rundschau* of December 17, 1927, the Wolmar Narrow Gauge Railroad lawsuit has been decided by the Senate in favor of the British bondholders.⁶ The Wolmar Railroad had obtained a court decision to redeem the 1910 loan of 1,699,866 rubles (£179,880), according to the provisions of an Act dated March 18, 1920, which devalORIZED bonds at about one per cent of their original gold par value. British bondholders presented the case before the Latvian Court of Appeal and won the decision. The Court agreed upon the principle that bonds which are payable in Latvia or abroad and which are to be redeemed in different currencies must be redeemed as "gold bonds." This decision is significant, inasmuch as it forms a precedent in the case of the Riga City loan from Lazard Brothers, now in default.

It appears that the default on the part of the City of Riga is about to be adjusted.

According to a report prepared by the American Consul in Riga, "the debt is of an adverse effect, not only upon the City's finances, but also on Government finances and private undertakings." Upon the settlement of the Lazard debt a new era in the economic development of the entire country will begin.

NOTE 12. According to information received from Norway, seven municipalities, including Aamot, Ognadal, Soerodal, Stange, Stangerland, Vardoe and Veltfjord, have declared their inability to meet their financial obligations, and are consequently declared to be in default with respect to their indebtedness. Details are not available, but it is stated that the total population of the municipalities involved is about 27,500.

NOTE 13. The service on the Lisbon Loan was suspended at the beginning of the war, as regards German holders, and no payments were made until July, 1917, when the Portuguese Government agreed to make payments in depreciated Portuguese currency. Bondholders protested against the nature of this payment, and negotiations are going on with a view to bringing about an adjustment of this situation. A settlement might be facilitated by the pending negotiations on the part of Portugal, as well as on the part of its capital, for loans abroad.

6. The Wolmar Railway Company obtained a loan in London in 1910 guaranteed, *inter alia*, by the Province of Livonia.

NOTE 14. In regard to the repudiation of the Russian indebtedness, the following decree issued by the Soviet Government and printed in the Russian newspaper, *Pravda*, under date of February 8, 1918, should prove of interest:

1. All State loans concluded by the Governments of the Russian landlords and Russian bourgeoisie, enumerated in a special list, are hereby repudiated as from December 14, 1917. The December coupons of these loans are not paid.

2. In the same way are all the guarantees repudiated which the said Governments gave to loans of various concerns and bodies.

3. All foreign loans, without exception, are absolutely repudiated.

4. Short-term liabilities and Treasury bonds remain in force. Interest on them is not paid, but the bonds themselves have a currency along with credit notes.

5. Poor citizens who hold State bonds of internal loans to an amount of not more than 10,000 rubles nominal receive in exchange certificates, made out in their names, of a new loan of the Russian rubles. The terms of the loan will be fixed later on.

6. Deposits at the State savings banks and interest on them remain intact. All debentures of the annulled loans which belong to the savings banks are replaced by a book debt on the part of the Russian Socialist Federal Soviet Republic.

7. Cooperative organizations, local government bodies, and other democratic bodies or institutions of common utility holding debentures of the repudiated loans are to be given certificates in accordance with rules to be drawn up by the Supreme Economic Council in conjunction with representatives of these bodies, which must prove that the debentures were acquired by them previous to the publication of the present decree. (Note:—The local organs of the Supreme Economic Council have to determine which of the local bodies can be regarded as democratic or of common utility).

8. The general direction of the liquidation of the State loans is entrusted to the Supreme Economic Council.

9. The work in connection with the liquidation of the loans is entrusted to the State Bank, which shall immediately begin the registration of all the debentures of State loans and other interest-bearing papers in the hands of various holders, which may or may not be subject to invalidation.

10. The Soviets, in agreement with the local economic councils, appoint committees to determine what citizens are to be regarded as poor.

These committees have the right to annul all savings not acquired by personal labor, even if they do not exceed the sum of 5,000 rubles.

NOTE 15. In regard to the Turkish debt, the following, published in the *Journal of Commerce*, New York, under date of September 11, 1927, is of interest:

Agents of the Turkish Government, and representatives of French, British, Belgian, German and Italian bondholders of the various Turkish loans are reported through an official release of the Association Nationale des Porteurs Francais de Valeurs Mobilières to have reached an agreement of principle.

The following stipulations in regard to the financial settlement of that part of the Ottoman public debt incumbent upon Turkey (an average of 67 per cent) are reported:

The first interest payment is to be made prior to June 1, 1928.

The Turkish Government agrees to make the annual disbursements indicated below, for that part of the debt charged to it: From 1928 to 1935, 1,980,000 Turkish pounds gold; from 1935 to 1941, 2,380,000 Turkish pounds gold; from 1941 to 1946, 2,780,000 Turkish pounds gold; from 1946 to 1951, 3,180,000 Turkish pounds gold; from 1951 until such time as payment in full can be made, 3,400,000 Turkish pounds gold.

The average percentage of nominal interest on the long term debt will be as follows: From 1928 to 1935, 38 per cent; from 1935 to 1941, 48 per cent; from 1941 to 1946, 58 per cent; from 1946 to 1948, 68 per cent; from 1948 to 1951, 90 per cent; from 1951 on, 100 per cent.

A special percentage will be provided in favor of the "Unified Loans" which would receive 48 per cent from the start, while other loans would receive only 35 per cent.

Payment will be made in the most appreciated currency, it being understood that loans for which the most appreciated currency is the franc will yield 100 per cent in that currency from the time of the first instalment.

Back payments, on which percentages will be the same as those given for corresponding loans, will be liquidated within a maximum period of thirty years. Treasury notes (Bons du Tresor) are to be included in this plan and to be consolidated into a loan to be paid up within twenty years.

As regards the question of guarantees, the Turkish Government offers the proceeds of the Constantinople Customs and of those of certain other ports. A few points remain to be decided upon.

No attempt has been made to discuss in detail the losses which may be assumed to have accrued to holders of obligations of an internal nature and which have depreciated in value to a very large extent as a result of the depreciation of the currencies in the respective countries.

SUMMARY

In summing up, it may be safe to state that default, or repudiation, as the investment world understands these terms today, is the unfortunate, but probably inevitable, by-product of a system of international lending which has, it must be admitted, conferred great and undoubted benefit upon mankind. We shall always find governments, municipalities, states and corporations—no less than individuals—who will incline to honor their obligations as long as this process is convenient, and to repudiate them when the hour of temptation arrives. However, the individual defaulter is generally subject to the laws of the land, but the investor who has lent his money to a government has traditionally been compelled to fall back on the expedient of refusing to allow the defaulting government to contract new obligations before taking care of the old. This safeguard, however, has not always proved effective, especially when the defaulting authority chooses to remain outside the new capital market.

The following suggestions have been made as possible remedies against governmental defaults:

1. Creation of a Council of American Holders of Foreign Bonds (similar to organizations existing in Great Britain, France, Belgium and other countries) under the auspices of leading banking interests, thereby making it difficult, if not impossible, for smaller and less important houses to undertake the flotation of foreign loans in the face of disapproval by the council.
2. Publication by the underwriters of foreign issues of accurate statistics relative to the economic and financial position of the borrowing country and of complete information regarding the past fiscal record of the borrowing country.
3. Cooperation between the American council and similar organizations in the various foreign countries with a view to preventing the flotation in any one market of a foreign loan on behalf of a foreign government which may be in default with respect to obligations traded in on other markets.
4. Agreement between the borrowing nation and its creditors to refer controversies to the League of Nations whose decisions would be considered final and binding.
5. Refusal on the part of existing stock exchanges to list the loans of countries which may be in default with respect to their obligations.

